Benefits of the Canada - United States Free Trade Agreement for Foreign Investors

Ministry of International Business
and Immigration
Province of British Columbia
Canada
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Message From the Minister

On January 1, 1989, the Canada-United states Free Trade Agreement came into force. With the advent of a new stage in trade relations between Canada and the United States, a series of trade policy changes immediately began.

These changes will enhance the ability of British Columbia businesses to access the vast United States market. This opportunity is also available to investors from countries other than the United States or Canada, who wish to establish in British Columbia to take advantage of this preferential trading status. It is our intention, through this publication, to highlight the many advantages that the Canada-United States Free Trade Agreement offers third country investors in British Columbia.

British Columbia is the ideal place from which to do business in the United States. We have the natural resources, skilled work force, vibrant economy, infrastructure, excellent living conditions, and the right attitude to help business succeed.

As Minister of International Business and Immigration, I welcome your interest, and guarantee our government's commitment to do everything possible to make your venture into British Columbia a rewarding experience.

Elwood N. Veitch
Minister of International Business
and Immigration

British Columbia

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the Canada-United States Free Trade Agreement
for Foreign Investors

Trade, Immigration and International Policy Division
Ministry of International Business and Immigration
Province of British Columbia

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EXECUTIVE SUMMARY

The Canada-United States Free Trade Agreement (FTA) has improved Canada's trading status with the United States and created an opportunity for Canadian businesses to expand into the U.S. market. Tariff reductions, improved temporary access for business persons, and institutional provisions provided for under the FTA have all improved the ability of corporations located in Canada to access the United States market.

The FTA also provides an opportunity for investors from "third countries" - that is, from countries other than Canada or the U.S. - to establish in Canada to take advantage of Canada's preferred trading status with the United States. Investors from third countries can benefit from the FTA, provided that the goods that they wish to trade with the United States meet the requirements specified in the FTA for Canadian and/or U.S. content. A number of factors make British Columbia an ideal location in which to establish to take advantage of these opportunities.

The following paper outlines the ways in which investors from third countries can take advantage of the FTA by establishing manufacturing operations in British Columbia, and outlines the basic requirements that must be met in order to do so.

INTRODUCTION

Since the January 1, 1989 implementation date, the Canada-United States Free Trade Agreement (FTA) has improved Canada's trading status with the United States and has created an opportunity for businesses located in Canada to expand into the U.S. market. It has also opened the door for investment in Canada from third countries - that is, countries other than Canada or the U.S. - wishing to take advantage of preferred tariff treatment on exports from Canada to the United States. The British Columbia government recognizes that investment in the province by non-Canadians is an important stimulus to economic growth and, consequently, actively promotes increased investment from outside Canada.

The purpose of this paper is to inform investors from third countries how they can take advantage of the opportunities created by the FTA. **It is important to note that the FTA rules which apply to bilateral trade in goods do not vary depending on the nationality of ownership of a plant which produces a product.** In other words, investors from third countries are able to take advantage of the same rules and regulations in the FTA as any other Canadian or U.S. investor producing from a plant in Canada or the U.S.

The rules and regulations that govern the preferred treatment available through the FTA are numerous and often product specific. They deal primarily with rules of origin, temporary access for business persons, and a number of other provisions designed to liberalize the trade and investment relations between the two countries. Because some of these rules are specific to certain products or certain types of commercial policies, it is difficult to summarize them. For this reason, this paper outlines the most important FTA trade issues which must be considered, but it is not an exhaustive review.

THE UNITED STATES MARKET

The United States continues to be British Columbia's most important trading partner. In 1989, approximately 41% of all British Columbia exports were to the United States.

With the FTA, British Columbia producers will have secure duty-free access to a United States market of 240 million people. In the western region of the United States alone, the FTA will give British Columbia industries duty free access to the five state economies of Washington, Oregon, California, Idaho, and Alaska. These states have a combined population of over 36 million people, and a combined personal income greater than all of Canada's.

Obviously, with the size and affluence of the United States market, **the FTA provides great opportunities for Canadian business** wishing to take advantage of the FTA. In almost all cases dealing with trade in goods, the FTA provides the same advantages to investors from third countries who wish to establish in Canada as a means to access both the Canadian and U.S. markets.

1. Tariff Reductions under the FTA

The FTA creates a free trade zone between Canada and the U.S. Prior to the FTA, between 75 and 80 percent of all trade between Canada and the United States was traded duty free. However, these figures obscure the fact that U.S. and Canadian tariffs were significant for many products and impeded bilateral trade in these protected goods. In certain product categories, tariffs were high and very little trade took place. Under the FTA, all existing tariffs between Canada and the U.S. will be phased out by January 1, 1998. For some goods, tariffs were eliminated when the FTA came into effect on January 1, 1989. For other goods, tariffs are scheduled to be phased out in equal annual stages over five to ten years. With the elimination of tariffs, a significant cost of accessing the U.S. market is removed.

2. Accelerated Tariff Reductions

In cases where Canada and the U.S. agree, the FTA stipulates that tariffs may be eliminated at a faster rate. This accelerated tariff elimination has been initiated through requests by businesses in the U.S. and Canada. In many cases, these requests for faster reductions in the phase-out of the remaining tariffs reflect the needs of producers in both countries who have streamlined their operations to take advantage of the FTA but still face residual tariffs as part of the 10-year implementation plan. Before an accelerated tariff for any individual item is implemented, there must be broad support in both countries from businesses producing the good in question.

The benefits of accelerated tariff elimination under the FTA were recognized by the private sector and in 1989 approximately 5,000 requests were made for accelerated tariff reductions. Approximately 400 tariff items in each country's tariff schedule are scheduled for faster reductions, starting on April 1, 1990. In keeping with industry requests, tariffs on most of these 400 items were eliminated on April 1, 1990. However, in a few cases, tariff elimination will be accelerated from a 10-year phase-out schedule to a five-year schedule. Foreign firms locating in Canada can participate in future rounds of the tariff acceleration process.

3. Drawback and Remission Programs

Canada has several programs which eliminate duties for imported goods that are re-exported to foreign countries, or which reduce or eliminate Canadian duties on imported goods destined for use in domestic manufacturing.

These programs can also be helpful to potential foreign investors who plan to locate processing operations in British Columbia but wish, at the same time, to source certain inputs from outside Canada and the U.S.

The main programs, are:

(1) Inward Processing Remission Order (duties* waived, but security posted);

(2) Duty drawback programs (duties reclaimed);

(3) Home Consumption Drawback Program (duties reclaimed);

(4) Bonded warehouses (duty deferral); and,

(5) The Machinery and Equipment Program (duties waived).

* The term 'duties' also includes sales and excise taxes as well as customs duties.

The FTA will affect some duty relief programs on trade between Canada and the U.S. With few exceptions, duty drawbacks on third country materials will be eliminated in Canada - U.S. trade after January 1, 1994. However, duty relief on exports to third countries will not be affected by the FTA.

4. Rules of Origin

The FTA is intended to benefit Canadian and American producers and generate employment in both countries, therefore, the FTA requires that goods receiving preferential tariff treatment under the FTA must be substantially produced in either or both countries. Under the FTA, Rules of Origin have been established to define which goods have been sufficiently processed in either Canada or the United States, or both, to qualify for preferential tariff treatment. Goods that do not meet the rules will continue to be subject to Canadian or U.S. duties in the same way that products from third countries will be subject to these duties.

As a consequence, the FTA's Rules of Origin are very important because they specify what content or processing steps in Canada and/or the U.S. are necessary to qualify goods for FTA treatment.

The FTA Rules of Origin are set out in Chapter Three and Annex 301.2 of the FTA, and are based on the Harmonized System of Tariff Classification and Statistical Coding (HS). The HS system is used in Canada, the United States, and many other countries. Every good that is traded between Canada and the United States is defined by an HS number. Goods that are wholly produced in Canada and/or the United States will qualify for preferential tariff treatment.

Specific rules of origin are used to determine which goods incorporating offshore raw materials have been sufficiently processed within the free trade zone so that the traded good qualifies for the FTA's preferred tariff treatment. As these rules are detailed and often product specific, it is difficult to generalize about the necessary requirements. In many cases, the minimum level of processing is determined by a **change in tariff classification of the output (based on the HS system) compared to the tariff classification of the imported third country inputs** used in its manufacture.

In some cases, in order to qualify for FTA treatment, a manufacturer must demonstrate that at least 50% of the direct cost of processing the good occurred in Canada and/or the United States. In many circumstances, goods incorporating third-country raw materials or components will qualify for the FTA tariff reduction or exemption if they have been sufficiently transformed, processed or assembled either in Canada or the United States or both.

For example, a bicycle assembled in Canada, using Canadian steel for its frame, but using wheels and gears imported from a third country, would qualify as a product of Canadian origin, if 50 percent of its direct manufacturing cost (i.e. materials and labour) is accounted for in Canada and/or the United States.

Exporters wishing to take advantage of the tariff status provided by the FTA, must therefore ensure that the products they wish to export conform with the rules of origin for that product. A Certificate of Origin is used to certify products as eligible for FTA treatment. To ensure that your product qualifies for FTA treatment, you may wish to contact your Customs broker or an investment counsellor at a Canadian embassy or consulate.

5. Performance Requirements

On occasion, governments have required that foreign investors buy some of their inputs from local suppliers or that a certain level of domestic content be met as a condition of establishing the investment.

Under the FTA, both Canada and the United States have agreed not to impose the following investment related performance requirements on investors from the other country:

- o minimum export levels;
- o import substitution;

- o local sourcing; and
- o domestic content requirements.

The FTA specifically extends this commitment to investors from third countries where such a requirement would have a significant impact on trade between Canada and the United States.

6. Temporary Access

Export sales today often require cross border movement of business personnel to facilitate the free flow of goods and services between countries. The sale of a good often requires extensive support services in terms of market research, product design and adaptation to a particular use. Once a good is sold into another market, the ability of the vendor to service that good is often critical to the success of his business.

To facilitate the movement of business persons between Canada and the United States, the FTA establishes improved bilateral temporary access provisions. "Temporary access" means entry without the intent to establish permanent residence. The new temporary access provisions do not alter Canadian or U.S. rules affecting permanent residence or citizenship.

The FTA's temporary access provisions have been designed to facilitate border crossings for four broad categories of business people: business travelers; professionals; traders and investors; and intra-company transfers.

In the business traveller category, a citizen of Canada seeking temporary entry, whose source of remuneration is from Canada, shall be admitted to the United States for the following activities:

1. Research and Design
2. Growth, Manufacture and Production
3. Marketing
4. Sales
5. Distribution
6. After Sales Service
7. General Service.

Early results of the FTA suggest that many British Columbia firms are benefitting from the broad range of activities permitted under the new temporary access provisions.

Individuals who are not Canadian citizens may require visas to visit the U.S., which are obtained in the normal manner.

7. Institutional Provisions

The FTA provides for the creation of working groups which address various outstanding issues and build upon the existing provisions of the Agreement in areas such as product standards, and the development of mutually agreed upon rules for the application of countervailing and anti-dumping duties. The various working groups allow the FTA to continue to meet the changing needs of the Canada-U.S. trade relationship.

A Canada-United States Trade Commission has also been established under the FTA to supervise the implementation, operation and elaboration of the Agreement and to resolve disputes over its interpretation. The Canadian Minister of International Trade and the U.S. Trade Representative represent their respective governments in the Commission.

8. Dispute Settlement Provisions

The FTA has extensive consultation provisions and dispute settlement mechanisms which provide the parties with more efficient and expeditious ways of avoiding and resolving disputes.

Chapter 18 of the FTA contains a general dispute resolution provision. Where disputes arise over the interpretations and application of the Agreement, or whenever a Party considers that an actual or proposed measure of the other party is or would be inconsistent with the Agreement, the Party may request that the problem be referred to a bi-national panel of experts. In the first year and one-half of operation, the panel process has been effective in assisting in the resolution of disputes.

When a dispute arises over a final countervailing or anti-dumping order, Chapter 19 gives the Parties the option of requesting a review of the order by a

bi-national panel. This panel process replaces judicial review of these determinations in both countries. The recommendation of a panel created under Chapter 19, is binding upon the Parties.

These improved dispute settlement mechanisms ensure greater certainty and fairness in the administration of U.S. countervail and anti-dumping laws, and put Canada on an equal footing with the United States in the resolution of trade problems which may arise between them.

INVESTMENT CANADA

Investors from outside of Canada should be aware of Investment Canada, a federal agency which promotes and reviews certain foreign investment.

It is important to note that, in recent years, Investment Canada has emphasized the promotion of foreign investment. In fact, many Canadian embassies and consulates have personnel on their staff whose responsibility it is to promote investment in Canada.

Furthermore, restrictions on foreign investment by Canada have been greatly reduced in recent years. For example, in the period June 30, 1985, (date Investment Canada was established) to March 31, 1988, there were 3,883 applications for foreign investment and not one was refused.

For further information, contact Investment Canada at:

240 Sparks Street, 5th Floor West
P.O. Box 2800, Station "D"
Ottawa, Ontario
K1P 6A5
Telephone: (613) 995-0465

CONCLUSION

The Canada-United States Free Trade Agreement provides an opportunity for British Columbia-based businesses to obtain preferential access to the enormous and affluent American market. Duty-free access, improved business travel access, and clearer trade rules all facilitate exporting to the United States.

These benefits can be shared by investors from third countries whose products meet the FTA's Rules of Origin. By investing in existing businesses in British Columbia, or by establishing new businesses, third country investors can benefit greatly from the FTA.

Further Information

A. For further information, or answers to your questions on investment opportunities in British Columbia, please contact your nearest British Columbia office (where available) or:

Investment Branch
Investment and International Operations Division
Ministry of International Business and Immigration
Suite 629, 999 Canada Place
Vancouver, British Columbia
V6C 3E1
Telephone: (604) 844-1823

B. For further information concerning the FTA and how it affects business and individuals in British Columbia, please contact:

Trade Policy Branch
Trade, Immigration and International Policy Division
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